

THE UNITED STATES AND JAPAN:  
COMPETITION AND COOPERATION

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## I. Introduction

The futures of the United States and Japan are today and forever more linked. It's a fact of life. It's never been clearer or truer than it is today. And it affords one of the most exciting opportunities and challenges for both of our countries.

That is why I am delighted to be with you today and grateful for the kind invitation to share with you some of my thoughts on a topic that has certainly preoccupied many of us in this room for some time. More to the point, this evening gives me the chance to take stock with you on where our relations, particularly in trade and economics, sit at the moment and where they may lead at a when George Bush is about to be sworn in as our nation's 41st president.

But as we face what is a difficult period of adjustment, there is nothing more certain than the depth and breadth of the U.S.-Japan relationship. Whether we are sitting across from one another at the negotiating table or not, we can always draw on a reservoir that has grown rich over forty years. There is no bilateral relationship quite like ours, and there will never be one quite like it again.

We stand today as world leaders. We share an economic maturity and stability that few others can hope to match. But in this strength comes responsibility. The world is watching as the

two great powers grapple with one another.

In the aftermath of the U.S. election, I believe both of our countries can take great comfort. Seasoned players who are tough but pragmatic and who have shown political savvy in the past will take center stage, and that is all for the good.

## II. An Historical Perspective

Let's step back for a moment and put all of this in perspective.

No understanding of what the United States and Japan face today is complete without coming to grips with the world as it existed just after the second world war. It is a history lesson that we cannot easily forget.

For the United States it was an unsettling period. Faced by a world literally torn apart, we quickly became the major political, economic, and military center of the globe -- not by choice, but by necessity.

General Douglas MacArthur, on behalf of the United States, took an unprecedented role in leading and working constructively with Japan to revitalize its shattered country, economy, and self-worth. What a tale it is today to hear Commerce Secretary William Verity reminisce about how his grandfather, the founder of Armco Steel, received the first stock certificate from Nippon Steel after he spent several years leading major support for the post World War II reconstruction of the Japanese steel industry.

For Europe, the Marshall Plan became the cornerstone of America's determination to help rebuild an entire continent. In retrospect, it is an incredible irony to listen to Vernon Walters, our Ambassador to the United Nations, speak of the days when he saw the first shipment of machine tools delivered to Germany -- a gift from the people of the United States.

For the United States the end of the war meant that the overseas markets came to us. If a country needed a steel girder or a consumer product, the United States furnished almost all of the world's imported needs. Chief executive officers of America's top corporations faced their stockholders with their profits soaring. Good decisions, bad decisions -- who knew what proper turns were being taken in the boardrooms during those heady days.

But what a difference 40 years makes. Over time we saw the advent of the multinational corporation where even U.S. companies foreign sourced their assembly of products for export to the United States. We witnessed the protection of specific industries, beginning with textiles in the late 1950's and early 1960's, through the complexity of a multi-fiber agreement. Finally, we watched the largest and richest marketplace in the world become the target of every country from East to West. For third world and industrialized world alike, the United States represented potential profit and economic growth. For Japan the U.S. market became the cornerstone of its export driven economy and growth for the future.

And for most of that 40 years the United States believed it was generally able to withstand the onslaught of increasing imports as well as -- quite candidly -- the barriers posed to us by a number of countries in accepting U.S. exports. We continued to maintain trade surpluses and our economic strength remained.

But the advent of the 1970's brought with it a new reality -- the reality that the United States could no longer remain the passive giant. Both in putting our house in order as well as in assuring a fair and open world marketplace, the questions of our own economic future came into focus as never before.

How we are proceeding along that path has been the subject of one of the most intense debates in the United States? Truly, we are confronting a time and place we have never quite known before.

Globalization and interdependence have made a critical difference in the way we deal with one another, and it is a trend that will never be reversed -- no matter what any single interest or person would like.

In fact, if you think about it, an American today can probably be defined as someone drinking Brazilian coffee from an English cup, who returning home in his German car from an Italian movie, sits in his Danish chair, picks up his Japanese ballpoint pen, and writes his congressman complaining about the trade deficit.

But make no mistake, the pressure points in confronting this new era for the United States have been overwhelming, and it

cannot be overstated how doggedly persistent the Reagan administration has been in holding the line in the advance of protectionism.

Right off the bat, the president inherited a government which already conceded that imports would surpass exports throughout the decade. By 1981 it became apparent that traditional surpluses enjoyed by the United States around the world were drying up and were being replaced by growing deficits.

As we come to the end of the Reagan administration, it has become obvious even to the most casual observer that the United States has had to face some hard, cold, and at times even cruel realities during the past eight years.

Gone are the days when the United States could withstand an overappreciated dollar as it did in 1984 and 1985. Gone are the days when the United States could stand as a lone buffer to the world and look the other way when countries provided industrial targeting of our domestic market and placed our own firms at a disadvantage in third country markets. Gone are the days when the United States could turn a deaf ear to its firms barred from freely competing in the markets of foreign countries when firms from those same countries were given unhampered access to the rich U.S. market.

What a different time and place it is today.

The convergence of all these forces, of course, has taken its toll. For the rest of this century the world will continue to watch the United States absorb itself in an examination of

conscience -- an intense introspection on its future role in the trading world. And of course no country has helped to bring this message home better than Japan.

Unlike Japan the United States has never truly developed an export culture. For most small to medium size businesses, the challenge has been exporting from Illinois to Indiana, and once that export market has been tapped, it's on to Ohio. When a business really wants to think "big", it starts to consider diversifying its product line. With a distribution system in the United States second to none, the road is simple.

This dependence on the U.S. domestic market, however, is only part of our problem. Notwithstanding many fine U.S. companies which are the most competitive in the world, other U.S. exporting firms simply have not made the grade. Slow delivery, lack of information on suppliers, poor after-sales service, and difficulties in placing small orders have been criticisms leveled against them. Many of these concerns have been justified.

A few years ago, the New York Times printed a passage from a newly declassified State Department memorandum, concerning a meeting of the National Security Council in 1954. According to the memo, then Secretary of State John Foster Dulles reported that he had told Japanese Prime Minister Yoshida "Frankly Japan should not expect to find a big U.S. market because the Japanese don't make the things we want." The New York Times excerpt was titled "Famous Last Words." The moral of the story is -- don't rule anything out. And I won't rule out the ability of American

business to compete now or ever.

But understand, too, how the development of an export culture becomes inextricably linked to the foundations of establishing a proper trade infrastructure. I am talking about an infrastructure that infuses primary and secondary schools with basic quality education in science, mathematics, languages, and geography. I am talking about an infrastructure that addresses our over burdened airports that are the hub for trade. I am talking about an infrastructure that continues to reward independence and innovation through sufficient research and development over time. These are the challenges out there for US. For Japan, a reluctant bride on the world stage, these past few years have been as rocky as they have been for the United States. No structural adjustment around the globe has been more difficult to confront than for the Japanese government and the Japanese people to comprehend and accept fully the economic predominance they have in today's world. To turn off the spigot of protecting the domestic market or of having Tokyo target foreign markets for Japanese goods has been exceedingly difficult. It is a process that continues to torment but one that must take place.

Nothing captures this adjustment or stands as a clearer milestone quite like the two Maekawa reports issued in 1986 and 1987.

The Maekawa reports of 1986 and 1987 were the products of an advisory committee to former Prime Minister Yasuhiro Nakasone,



chaired by former Bank of Japan Governor Haruo Maekawa to provide useful guides for structural reform in Japan.

The Maekawa reports recommended various measures to improve the Japanese standard of living. Such improvements, they argued, are needed not only to increase the welfare of Japanese citizens, but also to create the conditions for sustained increases in Japanese domestic demand and imports. Although continued economic growth in Japan and the appreciation of the yen since 1985 have raised Japanese per capita GDP to over \$20,000 (based on exchange rates for year end 1987) -- compared to a figure of about \$18,000 in the United States -- Japanese per capita income is only about 80 percent of U.S. per capita income on a purchasing power parity basis. That is, if Japanese per capita incomes are adjusted for what Japanese consumers can actually buy, their incomes are effectively 20 percent lower than U.S. per capita incomes.

The recommendations of the Maekawa reports addressed some of the obstacles to improving living standards in Japan and allowing Japanese consumers to increase their consumption of Japanese-made and imported products commensurate with the increased value of Japanese GNP. For example, the second Maekawa report strongly urged rapid reductions in the differential between Japanese and work market prices for agricultural products.

One final, timely example of the change in Japan extends to the current tax overhaul that Prime Minister Takeshita is shepharding through the Diet; an attempt to make the system more

equitable and to foster stronger domestic growth.

### III. The Current State of Play

For a moment now, let's look at the overall trade picture for our two countries. During the period January - September 1988 U.S. global exports were up almost 30 percent over a year earlier while U.S. imports were about 10 percent higher. If these trends continue, the 1988 U.S. trade deficit will register \$137.1 billion, down almost 20 percent from last year's \$170.3 billion deficit. Meanwhile, U.S. exports to Japan have increased almost 40 percent while U.S. imports from Japan are up less than five percent. At current rates, the U.S. deficit with Japan will decline by about \$7 billion.

Japan has also begun to reduce its foreign trade imbalance. It's yearly global trade surplus to date is about 20 percent lower than last year's comparable level.

However, it is much too early to count our chickens: both the United States and Japan still face massive foreign trade imbalances. In 1987, Japanese exports were 75 percent larger than Japanese imports and the Japanese trade surplus was equivalent to 3.8 percent of GNP. In comparison, the U.S. trade deficit was equivalent to 3.8 percent of U.S. GNP in 1987. Even after the improvement so far this year in the U.S. trade deficit, U.S. imports still exceed U.S. exports by over 40 percent, so U.S. exports must continue to grow substantially faster than U.S. imports to achieve further reductions in the U.S. trade deficit.

For this to occur, the United States and Japan must exert even greater efforts to achieve macroeconomic adjustment. Notwithstanding the U.S. and Japanese trade adjustments that have occurred, projections by the International Monetary Fund of continued external adjustment under current policies by the United States, Japan, and West Germany indicate that U.S. external liabilities and Japanese and West German external assets will continue to grow through 1992. Based on these projections, by 1989 U.S. net external debt will grow to the equivalent of 14 percent of GNP, from 7.9 percent of GNP at year end 1987. Meanwhile, Japan's net assets will reach the equivalent of 16 percent of GNP in 1989 (from 9.3 percent of GNP at year end 1987).

If the accumulation of U.S. foreign debt -- and the excessive growth of Japanese foreign assets -- is to be slowed and eventually reversed, appropriate fiscal and monetary policies, reforms to remove structural rigidities, and programs to reduce protectionism and dismantle trade barriers must be implemented by the United States, Japan, and our mutual trading partners.

#### IV. Tackling the U.S. Trade Front in the Bush Administration

How, then, will the Bush Administration proceed towards its overall trade and economic policy?

First, it is obvious that the next administration will be absorbed in the first few months of 1989 with implementing the

1200 page trade act; with executing the terms of the U.S.-Canada free trade arrangement; with the following through on the results of the mid-term review of the Uruguay Round in Montreal coming up in December; and with analyzing carefully all those directives coming out of Brussels in anticipation of the internalization of the European Community market. By 1992 the administration won't be wanting for things to do.

In other areas I think the future is also clear. On the question of dollar, the President-Elect has already made clear that he views with great urgency the need to establish the dollar's credibility and stability, and that means giving some sense of direction on addressing the budget deficit in the early days of his administration. That statement alone has helped to calm jittery markets for the time being.

In dealing with foreign unfair trading practices and even some if its own, the United States will continue to place a great deal of stock in the success of the Uruguay Round, recognizing that the multilateral approach to the international commerce of trade is the ideal approach. The current system needs to be fixed and the issues of agriculture, services, intellectual property rights and investment need to be covered.

Many of us see international commerce as a fine tuned instrument that can either be strengthened or be seriously impaired by its players. Wholesale forfeiture of the basic rules of free and fair trade can only lead to a calamitous fall for all of us. The central role that the United States plays in that

setting cannot be forgotten.

But until then and even after the conclusion of the Round, should proper and effective solutions not be found, I believe that the President will continue to rely upon his Section 301 authority under the Trade Act of 1974 and as it was amended under the new trade law. Inasmuch as we have had experience with Section 301 over the past three years, I think it is clear that this tool will be used as a surgical instrument when necessary.

Understand, though, that the new Trade Act of 1988 has placed greater pressures on the president to deal with the new Super 301 authority. Unlike existing 301 authority which targets sector or industry specific foreign trade barriers, super 301 is designed to combat generic or systematic trade practices employed by individual countries to restrict market access.

We may at times disagree on what steps the U.S. government should take to see that U.S. firms are competitive overseas, but there is one element in which we are agreed: when a foreign government uses its industrial, economic, and governmental might to erect barriers or to use that machine to target foreign markets, it is not only the right but the imperative of the U.S. government to consider the implications and to act accordingly.

If it determines that it is necessary to help broker an effective U.S. response, the administration will do so. Once the door is open and the rules of the game are clear and equitable to everyone, the time will come for us to step back.

But again, I believe that the Bush administration will be

careful not to have an itchy trigger finger. It just won't bury its head in the sand either.

Finally, we will see in a Bush administration greater attention focused on all elements of competitiveness, including trade promotion and the basic questions of how we solidify an infrastructure that will allow us to grow and accept more fully the challenges of being a trading nation.

#### V. Dealing with Japan in the Bush administration

In the midst of this picture what will the Bush Administration's approach be to Japan?

First, there certainly will be every effort made to develop an articulate and cogent approach to our relations with our ally. Given Congress' mandate to have the executive branch lay out its trade policy program, it's obvious that at the very least the Bush administration will need to put pen to paper on the state of our country's trade relations with Japan.

Furthermore, with James Baker at the State Department, we will have someone at the foreign policy helm who is experienced in dealing with the Japanese on the financial front from his former position as Secretary of the Treasury and on the trade front from his days as Chairman of the Economic Policy Council.

Steady hands, however, will not preclude tough calls being made when it comes to questions of Japanese industrial targeting or market access. Comparative advantage designed and engineered by government technocrats is an anathema to the United States and

will be responded to accordingly.

In particular, the Bush administration will strongly enforce this country's dumping laws and will keep a watchful eye on dumping in third markets, particularly when it comes to placing U.S. firms at a distinct pricing disadvantage.

Also, watch carefully how the next administration handles the issue of tied aid credits; that form of financing that links the contribution of aid to the third world explicitly to the purchase of goods from the donor country. Japan has continued to offer this kind of export financing, mainly under guidelines established among the industrialized countries of the Organization for Economic Cooperation and Development. The question, however, is whether the United States should show even greater aggressiveness in assisting U.S. firms which face financially supported competition by their government. With the greater involvement of Japan in the development of the third world, the temptations to use tied aid credits as an anchor for market share will grow even stronger. A U.S. Export-Import Bank study on the issue, completed by January, will certainly provide a key to U.S. options for the future.

The Bush Administration, of course, will find itself inheriting several discrete U.S.-Japan trade issues. If the Reagan administration does not lift the remaining sanctions on semiconductors, I fully expect the subject to be raised every time a bilateral trade meeting is held. The matter of market share v. volume sales will remain at the heart of the matter, but

I would find it inconceivable to see those sanctions lifted without genuine progress being made, supported by monthly U.S. export figures.

Another concern that will not go away deals with the ability of U.S. construction firms to compete fairly for bids on Japanese projects, particularly the multi-billion dollar Kansai Airport. This spring the Bush administration will face the one year anniversary of the U.S.-Japan agreement on public works.

As much as the new administration will need to continue to press the U.S. construction industry to shed its cynicism and aggressively bid for Japanese construction contracts, it will also be incumbent upon Japan to make every effort to open its market to first class U.S. construction firms.

Also, look for greater interest on the part of the U.S. government to address broader market access issues such as penetrating the Japanese distribution system. Thanks to the efforts of MITI Minister Tamura and Commerce Secretary Verity the initiative of "Market Japan with America's Best" became a highlight of the past year. A presidential trade mission, which I joined and which was headed by the Secretary of Commerce, traveled to Tokyo in September with 25 business men and women. Those individuals represented the consumer good sectors of furniture, jewelry, processed foods, leisure goods, and sporting goods.

The purpose of the trip was to educate and to penetrate one of the most cumbersome and costly distribution systems in the



world today. Here we are talking about an arcane and complex system that can add as much as 60 percent to the price of a Japanese product. As I found out quickly on that trip, an \$8,000 sofa at a department store is the norm. The trip was deemed a success, and other countries, interestingly enough, have followed suit. I would fully expect to see the Bush administration broaden that list of products and determine what future initiatives should be taken.

On the agricultural front it is fair to say that we will take a breather early in the new administration after the success of U.S. efforts to sell beef and citrus to the Japanese market and after the decision by U.S. Trade Representative Clayton Yeutter not to proceed with a 301 on rice. But it is also clear that the pressure to have Japan join us at the GATT in tackling our mutual egregious subsidy practices and those of the rest of the world will be put to the test. And let's be realistic, rice will continue to hang in the background.

One matter that will preoccupy the United States, however, will center around high technology as a whole. Over the past several years, we have watched our predominance in high technology goods slip world-wide, but it has been particularly the case with Japan. Market access and government subsidization will be watched very carefully. High definition television, supercomputers, telecommunications: all will be subjects fully addressed over the next year. And questions of complete protection of intellectual property will linger on in the high

technology area as well.

I would be remiss if I did not raise the issue of export controls on the Bush agenda. The Toshiba case, in which the Toshiba Corporation of Japan and the Kongsburg Corporation of Norway were found guilty of passing along to the Soviet Union the most highly classified information and equipment to advance their arcane submarine fleet to greater parity with the West, was a sad chapter for all of us. But I must stress that it did provide the critical two by four which has brought us closer together in overseeing export controls and has permitted us to see a more cohesive and determined COCOM. This issue will continue to be critical for the Bush team.

On another issue I will touch only briefly on investment, a subject that could be contained in its own lecture. But it certainly is apparent that the strength of our economy has produced an inward flow of Japanese investment into the United States at a record pace. In turn, that flow has allowed us to continue to grow at a time which the budget and trade deficits loom over us.

There are voices that would have us discriminate in various forms against Japanese investment on the grounds that it is different, that its intention is devious, and that it is not in the long term interests of the United States to be so dependent on foreign capital from any one country. To the U.S. investor who set up international operations overseas in the 1950's and 1960's, these echoes are familiar ones. Those were the days when

the United States was accused of unabashed hegemony and that our presence in overseas markets was somehow deluding the independence and economic freedoms of certain countries.

For the Bush administration, like the Reagan administration and even the Carter administration before it, the president will clearly resist calls for restrictions, for formal registration, and for any measures that somehow place foreign investment on a totally different footing than other kinds of domestic investment. This freedom of investment flows has been a major tenet of our country's economic policy since World War II, and it has been a priority subject of ours in the Uruguay Round. With the complex and intricate disposition of the world's economic system and the future of our own economic health in the years to come, we can ill-afford tampering with this delicate balancing act. The cost of good intentions would be enormous.

#### VI. Other Notions for Dealing with Our Trade Problem

Let me also raise just a few of the numerous suggestions that have been offered to improve the process of trade disputes.

One suggestion is to shift attention from means to ends: instead of pressing Japan to eliminate specific trade barriers and working out micro policies to allow U.S. firms to compete on equal terms with Japanese companies, the United States should simply insist on attaining a "fair" share of Japanese markets and leave it to Japan to find ways to assure this result. I would find this approach across the board to be very unlikely despite

some notions that have surfaced in recent academic debate.

Another suggestion is to negotiate a free trade agreement between the United States and Japan. Proponents of this idea believe that a U.S.-Japan FTA could go well beyond a traditional FTA to include domestic policies that adversely affect trade as well as mechanisms to allow more coherent, systematic, and regular means of resolving trade disputes. This notion is being studied on both sides of the Pacific right now, and I believe it is premature to place any kind of imprimatur on it. There are strong feelings on both sides of the equation in the executive branch.

A third suggestion has been to establish a permanent "Blue Ribbon Commission" composed of four or five experienced individuals from each side, working as private experts rather than as government delegates. These kinds of commissions have been used in the past by Presidents Carter and Reagan, but these were temporary panels and consequently could not provide long-term follow-through and guidance. The proposed commission would meet regularly and frequently and direct a permanent staff to get the facts and recommend fair solutions. Under this scenario, the Japanese and U.S. governments would agree in advance to accept the findings of the commission and perhaps let it mediate some trade disputes. Again, the jury is out.

That is what a great deal of the U.S.-Japan trade picture looks like to me. I probably should have titled my speech, "The United States and Japan: Competition, Cooperation, Continuity,

change, and challenge", but such indulgences in alliteration went out with Spiro Agnew. But it is true that all these words characterize different aspects of our relationship with Japan and will continue to do so in a Bush administration.

Competition will spur U.S. and Japanese companies to innovate and commercialize products in many areas to the benefit of not only American and Japanese consumers but the world as a whole. This will be healthy so long as the competition is fairly based, and that's where cooperation comes into play.

Cooperation between our nations ranges from joint ventures between U.S. and Japanese automakers which combine management and manufacturing techniques from both countries to the recently signed U.S.-Japan science and scientific research. It also calls on both of our countries to confront the hard realities of structural adjustment together.

In turn, continuity marks our joint efforts to resolve trade problems and to enlarge the sphere of economic coordination between our two countries. It is a continuity based on an alliance that has been and will continue to be unbreakable. Change characterizes our relationship as we look back to the reestablishment of peaceful world trade after World War II, and change will become ever more prominent in our relationship with each other and with third countries as the pace of technological development and economic linkages continues to race ahead.

Challenge is the earmark of our future. As the two largest economies of the free world, the United States and Japan share the

responsibility of facing and surmounting a number of formidable challenges. We must work together to reduce our own foreign trade and financial imbalances and to encourage other countries to do likewise, without endangering world economic growth and stability. We must find ways to resolve the prospects of the poorest countries of Africa and Asia. We must cooperate in providing generous and disinterested assistance to the developing countries of South East Asia and in supporting the further development of the region. We must work together to ensure stability in world capital and financial markets.

This I believe captures the Bush agenda in its relationship with Japan over the next few years. When it comes to the future of U.S.-Japan trade relations these days I feel as though I am in the middle of a good book. My biggest frustration is that I can't turn to the last page to see how it all turns out. All of us, however, realize all too well how much we need one another. We have a great deal of stake, and I'm not about to admit for one minute that we are not up to the adventure before us. Our biggest challenge will be to communicate and understand our relationship in the modern world more fully. As Goethe once said, "Nothing is more terrible than to see ignorance in action." We have got to make certain that misunderstandings and misperceptions do not lead to missteps.

But being the optimist that I am, I am bullish on our future. I am bullish on our new president, and I am bullish on all the early signals that have emerged from Prime Minister

Takeshita's government.

The only piece of advice that I would have for all of you in this room is to "stay tuned."